INDEPENDENT AGING AGENDA EVENT

Post-Event Summary Report

Name of Event: Social Security: Now and for the Future

Date of Event: Friday, May 27, 2005

Location of Event: Prisco Center, 150 Illinois Street, Aurora, IL 60506

Number of Persons attending: 22

Sponsoring Organization(s): NORTHEASTERN ILLINOIS AREA AGENCY ON AGING

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Priority Issue #1: Planning Along the Lifespan – Social Security Programs Now and for the Future

Barrier: The challenge facing Congress and the American people is to formulate a package of changes that will accomplish three goals while maintaining the fundamental qualities of the Social Security program that have made it so successful: a social insurance program characterized by near-universality, efficiency, progressivity, equity, inter-generational solidarity, and earned rights.

Any proposed change in the system should be evaluated in light of its impact on these characteristics. Social Security should be directed to advancing three broad goals:

1. Long-term (i.e., 75 years) solvency for the Social Security trust fund;
2. Greater financial security for present and future retirees from a combination of Social Security, private pensions, and personal savings;
3. Increased savings, both individually and for the U.S. government.

The primary goal should be the Social Security trust fund's long-term solvency, i.e., a trust fund that is sufficient to cover benefits each year for the next 75 years and that is stable or rising in the 75th year. Economists' and statisticians' projections of the date of the fund's depletion vary, mostly between 2041 and 2052, but there is little disagreement that it will happen if no changes are made to forestall it. The trust fund could remain solvent beyond the 75-year horizon, conceivably indefinitely, if the economy experiences a long period of sustained prosperity and growth, but it would be irresponsible to rely on such an optimistic forecast. Changes are therefore needed, and the sooner they are made, the less drastic they must be.

Personal or private accounts would not address the long-term solvency problem, but would exacerbate it. Diverting into private accounts money that would otherwise have gone into the trust fund will speed up the day when the trust fund is depleted. Private accounts would also do little, if anything, to offset benefit cuts. These accounts have a risk: the account holder would come out ahead only if, and to the extent that, the return on the private account exceeded the return on the trust fund's treasury bonds, currently about 3%. Even if the accounts are actuarially neutral in the long run, they create a huge cash-flow problem, often referred to as transitional costs. The total projected cost is in the neighborhood of $15 trillion, compared to the present total federal debt of about $7.8 trillion. Furthermore, most calculations of the supposed rate of return on the trust fund, to which private accounts are favorably compared, ignore the value of the survivors' and disability insurance that the beneficiary also receives.

Private accounts would allow, and even encourage, workers to forego part of a defined benefit that is adjusted for inflation, independent of market fluctuations and the economic cycle, and guaranteed no matter how long they live. In exchange they would get a benefit that has none of these advantages. Social Security should be the first and most reliable tier of retirement income, with a second tier combining pensions and personal savings in addition to Social Security, not in lieu of part of it.

The Social Security Administration's actuaries have certified that at least 11 proposals would restore "sustainable solvency" to the system for the 75-year planning horizon. However, most of those plans achieve this by depending on substantial cash infusions from the rest of the federal budget. This may be solvency of a sort, but adding billions of dollars to the already excessive federal deficit and mounting total federal debt would not be a sustainable option.

Such a transfer would also profoundly change the nature of Social Security. It is currently a self-financed program, with all the restraints that that implies. The Social Security trustees annually examine both the long- and short-term prospects of the system, and if necessary should recommend changes to bring benefits and revenues into balance. Unlimited transfers would discard that discipline, and replace it with an unlimited claim on the federal budget. Regardless of demographics and economics, the Social Security system would always be solvent, by definition.

Recommendation 1: Congress should consider a combination of measures that would restore and maintain solvency in a balanced fashion, so that no income group, age group, or other category of participants would bear an unfair share of the burden. This should include a combination of revenue increases and benefit cuts, ideally developed by a bipartisan commission so that no party or individual politician could accuse others of destroying the system. Revenue increases might include an increase in the payroll tax rate, an increase in the income subject to the tax (other than the annual COLA), and including state and local government workers in the program. Possible benefit cuts might take many forms, including an increase in the standard age of retirement with full benefits, an adjustment to the benefit formula, progressive indexing of the initial benefit, an increase in the number of years used to determine the benefit, an adjustment to the annual cost of living increase calculation, and reinstating the annual earnings test.

Characteristics of Social Security to be preserved

Social insurance – Social Security should remain an income protection plan for retirees, survivors, and the disabled, based on the insurance principle of shared risk and pooled resources. It should not be an individual savings or investment program. Such programs are desirable and necessary, but they should be in addition to Social Security, not replacements for part of it; i.e., "add-ons," not "carve-outs." The system must also continue to protect all three groups of beneficiaries: retirees, survivors, and disabled workers.

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Near-universality – The high proportion of Americans and American jobs covered by Social Security contributes greatly to its financial and political stability and to the individual's financial security. Adding more workers, such as state and local government employees, to the system would enhance this.

Efficiency – The program's present sound administration and very low operating expenses enhance public confidence in the system and conserve the system's payroll tax revenue for benefits. Any alternative system that would significantly raise administrative cost should be downgraded on this account.

Progressivity – The program's present progressive benefit structure should be maintained, so that those with the lower earnings will benefit more, relative to their contributions and lifetime earnings. These workers are least likely to have a private pension and substantial personal savings, and therefore rely more heavily on Social Security for financial protection.

Equity – The public perceives the Social Security system as basically fair to participants of varying ages, income levels, and other circumstances. There have been injustices in the past, such as the initial exclusion of domestic and agricultural workers, who were most likely to be minorities, and policies based on stereotyped assumptions about the roles of men and women. These have largely been eliminated. Some degree of controversy continues about issues such as the "notch" and the government pension offset. On the whole, however, public confidence in the system's equity is high, and must be maintained. Widespread perception of unfairness or bias in the Social Security system would be its deathknell. No proposed change in the Social Security system, regardless of its contribution to achieving any of the three goals, would be acceptable if it placed an unfair or intolerable burden on any income or age group.

Inter-generational solidarity – The Social Security system cannot be politically stable if Americans of different generations feel they are pitted against one another or in competition for inadequate resources. Despite the strong human tendency to consider one's own self-interest foremost, the system has generally been characterized by a sense of concern for people of all ages. Today's workers are both providing benefits to today's beneficiaries and accumulating some of the trust fund that will finance the baby boomers' retirement. Today's retirees and those nearing retirement age, who have been assured that they will not be affected by the various proposals for change, express concern for the long-term prospects of their children's and grandchildren's generations. Any change in the system must foster this sense of solidarity.

Earned rights – The American people respect the Social Security program and regard its benefits as earned, not as welfare or handouts. The relationship between payroll taxes paid and benefits received is clear, and no one feels or should feel any sense of shame or inadequacy in accepting the benefit. No change in Social Security should undermine this sense that benefits have been earned.

<u>Barrier:</u> Few Americans are saving enough to provide a supplement to Social Security that will give them a standard of living in retirement comparable to that of their working years. Government programs have not provided enough incentive for most low- and middle-income people to save, and the complicated programs intended to help them often overwhelm potential savers and lead to procrastination.

The third goal, closely related to the second, is increased U.S. savings, so that economic growth will enable the U.S. to meet its current and future obligations, including Social Security benefits financed by the Treasury bonds held by the trust fund, without impoverishing future generations. This goal includes both increased private savings and substantially reduced government deficits. Both the 1994-96 Advisory Council and the

President's Commission to Strengthen Social Security endorsed this fundamental goal of any reform proposal. This would be a far better approach to an "ownership society" than private accounts carved out of Social Security.

<u>Recommendation 2:</u> Greater financial security for present and future retirees should be another goal. The familiar metaphorical three-legged stool of retirement security (Social Security, private pensions, and personal savings) is increasingly shaky. The government must take steps to keep Social Security benefits secure and adequate, while bolstering the private pension system and encouraging personal savings.

Among the ways to simplify savings:

- Make saving through 401(k) accounts the norm, in several ways: making participation the default setting (i.e., workers are enrolled unless they opt out, instead of vice versa); increasing an employee's contribution in a standard way, such as when pay rises (again, with an opt-out provision); invest in a balanced, prudently diversified, low-cost investment package such as broad index funds, life-cycle funds, or professionally managed funds, unless the employee makes other choices; and automatic rollover to an IRA, 401(k) account, or other plan offered by a new employer when an employee changes jobs.
- Allow part of a federal income tax refund to be deposited in an IRA. Under current law taxpayers can direct the IRS to deposit a refund in a designated account, but only in one account, so it is an all-or-nothing approach. Few taxpayers are willing or able to save their entire refunds in an IRA, so many forego such savings entirely. Allowing a refund to be divided, with part going into an IRA, would encourage saving at least that much. This provision would be even more effective if the IRS were allowed to establish IRAs for this purpose for taxpayers who do not have them, or to buy government bonds for taxpayers with part of the refund.

Among the ways to increase the incentive to save:

- Revise the Saver's Credit, which provides a nonrefundable tax credit for voluntary individual contributions to IRAs, 401(k) plans, and similar retirement savings arrangements for taxpayers with adjusted gross incomes up to $25,000 for singles and $50,000 for couples. Research shows that this program would be more effective if it were a matching contribution to the account, on a sliding scale, rather than a tax credit, and were available regardless of income tax liability.
- Reduce the implicit tax on retirement savings imposed by asset limits for means-tested government benefits, such as food stamps, Medicaid, subsidized housing, and the subsidy for the new Medicare Part D drug benefit. In addition to this general principle, laws have not kept up with a significant change in the American economy: Although pensions are a declining proportion of retirement income, especially for low- and middle-income retirees, many means-tested government benefits exempt income from a defined benefit pension plan, but count savings in IRAs and 401(k) accounts. This inequity should be eliminated.

Avoiding further tax subsidies for the wealthy and for asset-shifting:

- The Retirement Savings Account (RSA) proposal would create what is essentially a Roth IRA with no income limit. RSAs and higher income limits for Roth accounts would benefit primarily those subject to the Roth income limits of $95,000 for single people and $150,000 for couples. About three-fourths of the tax subsidy from RSAs would go to the 3% of households with incomes of more than $200,000, including one-fourth to the 0.6% of households with incomes above $500,000. This segment of the population does not need encouragement or assistance to save. The policies should be designed to assist and encourage savings by low- and moderate-income people, who are less likely to be financially well prepared for retirement, not the wealthy.

- Another undesirable change would be to increase the limit on IRA and 401(k) contributions, since this would benefit only the 5% of 401(k) participants and 5% of those eligible to contribute to IRAs who make the maximum contribution. Most of these people also save in addition to their IRA or 401(k). Increasing the contribution limit would therefore simply allow them to shift some of that additional saving to the tax-sheltered account, rather than increase their total savings.
- Furthermore, these proposals would add substantially to the federal deficit in the long run because they are "backloaded." Most of their costs would be incurred, not during the initial 10-year forecast period, but when the funds are ultimately withdrawn from the accounts taxfree, decades later. They would also hurt many states' long-term revenue prospects because states' definitions of taxable income are usually based on the federal definition.